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UNITED STATES REPRESENTATIVE
TO THE
EUROPEAN COMMUNITIES

40, BOULEVARD DU REGENT, B 3
1000 BRUSSELS, BELGIUM

July 14, 1986

Mr. William Casey
Director
Central Intelligence
Agency
Washington DC 20505

Dear Bill,

This is just a quick note to congratulate you on your speech of September 18, to the Dallas Council on World Affairs, entitled "Soviet Use of Active Measures." It is the clearest and most persuasive indictment of Soviet subversion and disinformation that I have yet seen.

We have put your presentation to good use here in Europe, where -- despite a general disillusionment with the Soviet system -- there remains, in some intellectual quarters, a tendency to equate the activities of the two superpowers as "moral equivalents" with "pragmatic" Europe as the arbitrator.

With best regards,

Bill

J. William Middendorf II
Ambassador

P.S. Today I'm sending The attached on Socialist Europe to The W.S.J.

Bill

B-801-IR

ARTICLE BY AMBASSADOR J.W. MIDDENDORF, II
U.S. AMBASSADOR TO THE EEC
PRIVATIZATION, TAX RATES AND GROWTH

Although the term, "privatization," is a recent addition to the modern economic lexicon, the concept is gaining impressive acceptance around the world. It is part of a world-wide trend away from big government, a trend I view in the most positive light. Such is the current popularity of privatization that few were surprised when the new French cabinet of Prime Minister Jacques Chirac announced the name of its Minister for "Economics, Finance and Privatization." The unique cabinet title is but one of many indications that transferring functions from government to the private sector is rapidly becoming the wave of the future, thus reversing a two-decade long trend in the opposite direction. Returning to Europe for a second ambassadorial assignment here after a 13-year hiatus, I am struck by the transformation in European thinking. Earlier, Europe was rushing pell-mell to increase government ownership in many areas. All across the continent today, I note that governments are examining ways to divest themselves of costly state-owned enterprises. They are also looking at ways to deregulate and open up state monopolies to the beneficial effects of competition and profit motivation.

Great Britain has been a European pioneer in reducing government participation in its economy. According to the OECD, 12 major U.K. public enterprises were privatized between 1979 and 1985, involving the sale of public assets totalling about $9 billion and the transfer of 400,000 jobs to the private sector. During the same time, the number of shareholders in the U.K. has doubled to six million people. The privatization plans reportedly being discussed by the recently-elected government in France also appear far-reaching. Germany, Spain, Italy and other European countries are studying and in some cases beginning to implement a variety of denationalization strategies. A few years ago the conventional wisdom was that Turkey was a basket case. Now suddenly, the Ozal administration is following free enterprise philosophies and reaping the benefits. It has eliminated most restrictions on foreign investment in Turkey and established a financial market. On May 27 the Turkish parliament passed a bill abolishing the state tobacco monopoly and outlining the privatization of the state economic enterprises. The result of these policies has been a surge in exports and a multitude of investors seeking joint ventures in Turkey.

The fact that privatization has become one of the hottest topics in Europe today reflects the growing disenchantment with big government as a major provider of goods and services. With government spending at over 50 per cent of GNP in virtually all European countries and with public enterprise employment ranging up to 12.5 per cent in the major countries, the highly taxed European citizen seems to have concluded he is not getting enough for his money.

As a U.S. tax payer who has often raised the same question about the end result of his own taxes, I can only applaud the direction of the debate. Although we have never moved as far as Europe in government intervention in the economy (only 1.5 per cent of the employed labor force is in public enterprises), the Reagan Administration is committed to turning more of our small federal share over to the private sector. The Administration has proposed, as part of its current budget proposal, the sale of our government-owned railroad, Conrail, and federal assets, including five power marketing administrations, naval oil reserves, the Federal Housing Administration, the Overseas Private Investment Corporation, and functions of the Export-Import Bank.

By reducing the size of government through elimination of the vast deficits to which most government enterprises are afflicted, privatization can serve as a vehicle for lower taxes, thereby spurring investment and economic growth. On the subject of taxes, there is a good deal of confusion about the effect of tax rates on growth. Contrary to conventional wisdom, lower tax rates do not necessarily mean decreased tax revenues. In fact, lower tax rates often produce higher revenues because they encourage initiative and bring back money that is channelled into the underground economy and unproductive tax shelters. American economist George Gilder, for instance, has studied the 1979 tax reduction by the Thatcher Government from 98 per cent rates on unearned income and 83 per cent rates on earned income down to the current top marginal rate for both of 60 per cent. The result, according to Gilder, is that revenue did not go down as predicted, but went up, even in the midst of recession.

Another telling case is India where Prime Minister Rajiv Gandhi slashed tax rates across-the-board. In the first six months of the Indian fiscal year, ended last September, revenue from income taxes climbed some 27 per cent, or nearly $4 billion, from a year earlier. Overall tax receipts jumped 25 per cent, while revenue from personal income tax alone climbed 40 per cent. A recent, pioneering survey on tax structures in nearly 100 developing countries by Alvin Rabushka of Stanford University, and Bruce Bartlett of the Heritage Foundatin draws the same conclusion. Their study points out how countries that have reduced marginal tax rates have fared much better than those which have shown excessive concern with "soak-the-rich" policies, which I view as the "politics of envy." Their data indicate that the best "soak-the-rich" policy actually would be to lower marginal tax rates, because this would most likely increase the amount the rich would pay to the government.

Many Europeans are now saying that, as the last 20 years have shown, the runaway welfare state concept has had its full chance with massive infusions of funds and has been found wanting. Despite all of this borrowed and taxed money, unemployment here in Europe has gone from 3.5 per cent to 11 per cent in the last 13 years. Most European governments provide a generous cushion of unemployment benefits, and Europeans have told me that this compassionate treatment of the unemployed contrasts with the "heartless" U.S. approach. I ask, though, is it not more compassionate to offer a worker increased job opportunities rather than providing fewer job opportunities and far more generous benefits which governments can afford less and less. Unusually large benefits often act as a disincentive for employers to hire new workers and for the unemployed workers to seek new jobs.

Experience has proven that governments do not create jobs, businesses do. If it costs $50,000 to create one job in Europe, where are the billions to come from for the new jobs of the future? While the U.S. economy created over 27 million net new jobs during the last 15 years, Europe actually lost jobs, and European unemployment increased five fold. Some European governments are already spending nearly two thirds of the entire Gross National Product of their people. These governments cannot borrow and tax much more than they are doing now for additional unemployment benefits and job training. If, despite all this spending, there is a repeat of the last 10 years' experience, what are the job creation prospects for the next decade? Fortunately, European leaders and, in fact, leaders throughout the world are beginning to see that the answer lies in allowing the free market genie out of his bottle. German Chancellor Helmut Kohl's policy statement of May 4, 1983, summarizes this evolving attitude toward government. He said, "The more the government stays out of the picture, gives free rein to the individual, the more successful the economic system will be. We want less government, not more. We want more, not less, personal freedom."

I am heartened that Europe is now returning to the fundamentals of its own economic libertarian minds, such as Adam Smith, Carl Menger, Friedrich von Hayek, Frederic Bastiat, and Ludwig Von Mises, whose ideas have revolutionized economic thinking over the past century. The imported concepts of these Europeans have laid the foundation which in turn has helped build America. The winds of change in Europe offer the promise for long-term sustained economic growth. By transferring unproductive resources into productive hands, privatization can unleash the full potential of the free market. Privatization, less government interference in the economy, and lower tax rates are not panaceas, because with all systems there will be business cycles. These are, however, some of the strongest prescription drugs available to combat the economic ills of our time. As President Reagan stated on May 3 to the American Chamber of Commerce in Toyko, "In the Post-War period, the world has undergone a kind of experiment in which two basic development models have been tested. One is based on central planning and high taxes, the other, on free enterprise and low taxes. The results of the experiment are in. Freedom works."

Ambassador J. William Middendorf, II

UNITED STATES REPRESENTATIVE
TO THE EUROPEAN COMMUNITIES

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